

P-421/EI-89-860 ORDER AMENDING INCENTIVE PLAN AND ACCEPTING
INCENTIVE PLAN FILINGS

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

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In the Matter of U S WEST
Communications, Inc.'s Incentive
Regulation Plan

ISSUE DATE: May 20, 1991

DOCKET NO. P-421/EI-89-860

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PROCEDURAL HISTORY

Incentive Regulation Generally

During the 1989 legislative session the Minnesota Legislature enacted an incentive plan statute, allowing telephone companies to file proposed incentive plans for Commission approval. Minn. Stat. § 237.625 (1990). Incentive regulation is an alternative to traditional rate of return regulation. Under incentive regulation a company is allowed to earn amounts in excess of its authorized rate of return, and is required to share a specified percentage of such amounts with its ratepayers. The percentage of excess earnings to be shared is set by the Commission to reflect the relative risks the plan imposes on ratepayers and shareholders. Companies operating under incentive regulation cannot raise their rates except under carefully limited circumstances.

Incentive regulation is a new regulatory tool. The legislature authorized its use on an experimental basis and provided for automatic repeal of the incentive plan statute in 1994.

History of this Proceeding

On October 30, 1989, U S WEST Communications, Inc. (U S WEST or the Company) filed a proposed incentive plan. The Commission convened an expedited proceeding to consider the plan. In the course of this proceeding the Commission held public hearings, received evidence and briefs from interested persons, heard oral argument, and issued an Order accepting the plan subject to specified modifications. FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER, this docket (June 7, 1990).

On September 17, 1990, the Commission issued its ORDER AFTER RECONSIDERATION AND CLARIFYING ORDER OF JUNE 7. The second Order revised three of the modifications required under the first Order and clarified statements in the first Order the parties found ambiguous. On October 5, 1990, the Company accepted the incentive plan as modified by the Commission.

The Filings at Issue

The Orders modifying and adopting the proposed incentive plan required the Company to file detailed financial reports annually and to serve them on the Department of Public Service (the Department) and the Residential Utilities Division of the Office of the Attorney General (RUD-OAG). On April 1, 1991, the Company filed and served its 1990 financial reports. Those reports showed that the Company's 1990 earnings were substantially higher than its earnings in 1989.

On May 1, 1991, following preliminary examination of the reports by the Department and the RUD-OAG and discussions between the Company and those parties, the Company filed its Notice to the Commission - Incentive Plan Sharing Summary (Sharing Summary). The Sharing Summary stated that the amount to be distributed to ratepayers under the incentive plan was approximately \$3.46 million.

The Department filed comments recommending two adjustments to the Company's earnings calculation: (1) excluding the costs of developing services not yet offered in Minnesota which have been deregulated by the Federal Communications Commission (FCC) but not by the Minnesota Commission; and (2) imputing revenues the Company would have earned from the sale of foreign directories, had it not misinterpreted a Commission Order.

The Department also recommended cautioning the Company that the Commission will take corrective action if FCC-deregulated services whose development was funded in part by ratepayer funds are deregulated in Minnesota before the ratepayers' investment has been recovered. Similarly, the Department recommended emphasizing that the Commission reserves the right to investigate affiliated transactions in greater detail at a later date. Finally, the Department recommended that in the future the Commission extend the period for commenting on the Company's annual incentive plan filings to 60 days, to allow more thorough review by interested persons.

The RUD-OAG filed comments objecting to the Company's excluding, from revenues subject to sharing, revenues refunded in settlement of a class-wide consumer complaint. Otherwise, the RUD-OAG believed the filing was in compliance with the plan and the Commission's Orders.

On May 13, 1991 the Company submitted a proposal to change the incentive plan's sharing calculation to remove the financial

effects of all services deregulated by the FCC, whether or not they are deregulated in Minnesota. This proposal would increase the amount distributed to ratepayers for calendar year 1990 by nearly three million dollars. The Department and the RUD-OAG withdrew their earlier recommendations in favor of the Company's proposal, although the Department continued to recommend a longer review period for annual incentive plan filings.

The matter came before the Commission on May 14, 1991.

FINDINGS AND CONCLUSIONS

Treatment of FCC-Deregulated Services

The incentive plan originally filed by the Company excluded the financial effects of FCC-deregulated services from earnings and sharing calculations under the plan. In the June 7, 1990 Order modifying and accepting the plan, the Commission adopted the Department's recommendation to include FCC-deregulated services, unless such services had been deregulated in Minnesota. This decision was based in large part on the understanding that the financial effects of those services would be negligible:

The Company indicated that inside wire, which has been deregulated by both the Minnesota Commission and the FCC, constitutes approximately 99% of the Part X removals [FCC-deregulated services] as reflected in exhibit BKY-3. The Company declared that all other services identified and removed under Part X Cost Allocation Manual procedures are immaterial to the sharing calculations of the plan.

FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER, this docket (June 7, 1990), at 19.

The Commission originally included these services in the plan because inclusion was consistent with their regulated status. The Commission had been advised that the accounting techniques for including them were inexact and that disregarding them would simplify the administration of the plan. Since the financial effects were expected to be negligible, however, the Commission decided to sacrifice a measure of accuracy and administrative simplicity to protect ratepayer investments in FCC-deregulated services¹ and to avoid any potential for confusion about the regulated or deregulated status of such services in Minnesota.

¹ "Ratepayer investments" is a shorthand reference to the fact that FCC-deregulated services not deregulated in Minnesota have been developed in part with ratepayer funds.

The Company's unexpected losses on FCC-deregulated services in 1990, however, belied its earlier indication that the financial effects of these services would be de minimus. As it turns out, for calendar year 1990, excluding FCC-deregulated services from earnings and sharing calculations would increase ratepayer refunds by 85%. Under these circumstances, it is reasonable to re-examine the plan's treatment of FCC-deregulated services.

The Commission finds that adding the financial advantage to ratepayers to the originally understood advantages of straightforward accounting and administrative convenience tips the scales in favor of excluding FCC-deregulated services from earnings and sharing calculations. The Commission will therefore amend² the plan to exclude the financial effects of FCC-deregulated services, whether or not such services are currently deregulated in Minnesota.

This decision is not and should not be viewed as a precursor to the deregulation of any or all FCC-deregulated services in Minnesota. Neither does it bind the Commission to any particular accounting or ratemaking treatment of these services in future proceedings in other dockets. It simply reflects the Commission's recognition that, for the limited purposes of calculating earnings and sharing under the incentive plan, the financial effects of these services should be disregarded.

Filing Dates and Review Period

The Department asked the Commission to extend the time for filing comments on U S WEST's future incentive plan filings, saying this year's 36-day comment period was barely adequate. The Commission agrees with the Company that timing concerns are best addressed on a case by case basis.

The June 7 Order requires an extensive April 1 filing, complete with work papers, followed by a final filing on May 1. The May 1 filing is expected to reflect the results of discussions and information exchanges between the Company, the Department, and the RUD-OAG. Since the plan requires sharing to take place during the July billing cycle, comments on the final May 1 filing must be filed within a few days of its receipt.

Changing these deadlines in either direction is problematic. Requiring the first filing before April 1 would compromise its usefulness, since the Company would not yet have accurate financial data compiled. Extending the comment period on the May 1 filing would jeopardize the Company's ability to implement sharing during the July 1 billing cycle, when ratepayers presumably expect it.

² The only equitable way to implement this change is to amend the plan itself, ensuring that FCC-deregulated services will be treated the same whether they show a profit or a loss.

The Commission will retain the current filing schedule for at least another year, since it is likely that further experience with the plan and the annual financial filings will simplify future comment processes. If problems develop in subsequent years, the Department or any other party may of course seek a time extension.

ORDER

1. The Commission, by agreement with the Company, amends the incentive plan to exclude FCC-deregulated services from earnings and sharing calculations.
2. The exclusion of the financial effects of FCC-deregulated services from earnings and sharing calculations under the incentive plan in no way affects the regulated status of any FCC-deregulated service which has not been deregulated in Minnesota.
3. The Commission accepts the Company's April 1, May 1, and supplemental filings as in compliance with the requirements of its June 7, 1990 and September 17, 1990 Orders.
4. Within 10 days of the date of this Order the Company shall file revised incentive plan pages reflecting the exclusion of FCC-deregulated services from earnings and sharing calculations under the plan.
5. Within 10 days of the date of this Order the Company shall make a filing detailing its final calculations of the amount of 1990 earnings to be shared with ratepayers, together with a proposed customer notice and a time line for implementation of sharing.
6. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Richard R. Lancaster
Executive Secretary

(S E A L)